CANADIAN SECURITIES LITIGATION OUTLOOK

Trends to Watch for Capital Markets Participants

2016 UPDATE

CASSELS BROCK
LAWYERS

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OUR SECURITIES LITIGATION TEAM

Cassels Brock’s securities litigators have extensive experience advocating on behalf of market participants including issuers, advisors, directors, officers and shareholders in high stakes civil and regulatory disputes. Litigators on our versatile team have been recognized by *Lexpert*, *Chambers Global*, *Best Lawyers in Canada* and *Martindale-Hubbell*, and are complemented by leading practitioners from our corporate securities group.

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TRENDS TO WATCH FOR CAPITAL MARKETS PARTICIPANTS

In this issue of Canadian Securities Litigation Outlook, we review the following recent developments shaping the trends to watch in 2016: securities class action defence strategies, gatekeeper liability, insider trading prosecutions, the progress of Canadian securities regulators in enforcement initiatives, including credit for cooperation, whistle-blower regimes and other initiatives, and the impact and regulation of short seller activity in Canadian capital markets.

In the secondary market class action context, we examine the implications of the Supreme Court of Canada's clarification of the leave threshold, and review some recent examples of successful defence strategies.

We consider the increased focus on gatekeeper liability through the lens of auditor and underwriter liability in the secondary market liability context and the securities regulatory context.

Recent successes in the prosecution of insider trading cases highlight the regulator's ability to successfully prosecute in the absence of a "smoking gun" through effective reliance on circumstantial evidence.

The Ontario Securities Commission's credit for cooperation initiatives, pilot mediation program and proposed whistleblower policy are all examples of efforts to achieve enhanced enforcement and efficient resolution of regulatory matters.

Finally, with the recent wave of short seller reports hitting Canadian issuers with devastating results, we review the one attempt so far by a Canadian securities commission to regulate such activity and the troubling implications from short seller activity. It remains to be seen whether securities regulators will continue to step into the fray in the future.

We will continue to monitor and report on these and other key developments as they unfold.

1 SECURITIES CLASS ACTION "CHILL"?

Over the past year, Canadian courts have released a number of decisions in securities class action cases that have helpful implications for public companies (and their officers and directors) in defending against costly claims for secondary market misrepresentation. This article reviews recent encouraging developments and highlights defence strategies that have proven successful in defeating potential securities class actions.

AFFIRMATION OF A MEANINGFUL LEAVE TEST

In order to ensure that unmeritorious claims are not advanced, the Ontario *Securities Act* (the "OSA")[1] includes a screening mechanism which requires a plaintiff to obtain leave from the court prior to commencing a statutory secondary market liability action by demonstrating that: (1) the claim is being brought in good faith, and (2) there is a reasonable possibility that the plaintiff will succeed at trial.

Until recently, Canadian courts had developed a "relatively low threshold" that plaintiffs were required to meet in order to be granted leave to proceed with their claim.[2] However, in two key decisions in 2015,[3] the Supreme Court of Canada unanimously confirmed that the "reasonable possibility" requirement of the leave test is more than just a procedural formality and that courts "must undertake a reasoned consideration of the evidence to ensure that the action has some merit." Under this more rigorous test, the Supreme Court has held that plaintiffs are required to advance both a "plausible analysis of the applicable legislation provisions" and "some credible evidence in support of the claim."

This shift in the law signals that… a robust response to leave motions may be warranted and worthwhile.

SUCCESSFUL DEFENCE STRATEGIES ON LEAVE MOTIONS

The Supreme Court's affirmation of a meaningful leave test is a positive development for public companies as it requires plaintiffs to meet a higher evidentiary burden on leave motions. This shift in the law signals that, in appropriate cases, a robust response to leave motions may be warranted and worthwhile. A review of subsequent decisions on leave motions establishes the following trends in successful defence strategies.

Substantial Evidentiary Records May be Appropriate

Although the Supreme Court has cautioned that leave motions should not be treated as a "mini-trial" with a full analysis of evidence, a substantial evidentiary record may be warranted where the record can establish that no misrepresentations have been made.[4] For example, in *Coffin v. Atlantic Power Corp.*,[5] the plaintiffs alleged that Atlantic Power had made misrepresentations about

1 For ease, we will reference the Ontario securities regime, however similar statutory secondary market liability regimes, including a screening mechanism, have been implement in securities legislation for each of the provinces and territories.

2 *Green v. Canadian Imperial Bank of Commerce*, 2014 ONCA 90.

3 *Theratechnologies Inc. v. 121851 Canada Inc.*, 2015 SCC 18; *Green v CIBC*, 2015 SCC 60.

4 The court in *Bradley v. Eastern Platinum Ltd.*, 2016 ONSC 1903, provided further guidance on the Supreme Court's test in *Green v. CIBC* noting that the leave test now "requires a robust, meaningful examination and critical evaluation of the evidence (or the absence of evidence)." The court drew parallels to a motion for summary judgment, noting that both frameworks require the examination and weighing of evidence (in contrast to a motion to strike). The court further noted that while there is no obligation on a responding party to file evidence on a leave motion, it may be a "risky venture" not to do so where there are highly contentious factual issues.

5 *Coffin v. Atlantic Power Corp.*, 2015 ONSC 3686.

its ability to sustain its dividend payments, causing shareholders to suffer losses when the dividend was cut and the company's share price dropped. In response to the leave motion, the defendants relied on over 14,000 records to show that it had not made any misrepresentation. Evidence included expert reports, affidavits, and non-public, court-sealed corporate narrative evidence. Following a thorough review of the evidence, the Ontario court concluded that there were no misrepresentations by assertion or omission, or material changes that were not disclosed and that there was no reasonable possibility that the plaintiffs could show otherwise at trial. Accordingly, the motion for leave was denied.

Expert Evidence can be Crucial

Although costly, in appropriate cases,[6] expert evidence may be the silver bullet in leave motions, as in *Mask v. Silvercorp Inc*.,[7] a putative class action against Silvercorp for alleged misrepresentations in respect of the company's mineral resources and reserve estimates for its mine project in China. In support of their motion for leave, the plaintiffs filed an expert report identifying misrepresentations by comparing two reports released by Silvercorp which provided seemingly different mineral results. In response, Silvercorp filed an affidavit from an expert explaining that different reporting parameters had been applied to the two reports and, therefore, there were no actual discrepancies between the mineral results contained in the two reports. In considering the expert evidence, the Ontario court noted that the plaintiff's expert failed to rebut or even address the conclusions of Silvercorp's expert. As a result, the motion for leave was denied by the court on the basis that the plaintiffs had failed to adduce sufficient evidence of a misrepresentation and therefore failed to "clear the leave hurdle."

Although costly, in appropriate cases, expert evidence may be the silver bullet in leave motions.

Continued Focus on "Reasonable Probability" and not "Good Faith"

In most cases, defendants' resources on a leave motion appear to be best spent focusing on the "reasonable probability" branch of the leave test, as opposed to the "good faith" branch. The "good faith requirement" has been interpreted as requiring plaintiffs to establish that their action was brought in the honest belief that they have an arguable claim, and for reasons that are consistent with the statutory purpose and not for an oblique or collateral purpose.[8] In the recent *Silvercorp* case, the defendants attempted to rely on cross-examination evidence to establish that the action had not been brought in good faith because the plaintiff had not shown a personal belief in the merits of his own case. The Ontario court rejected this argument and held that the plaintiff's affidavit evidence was sufficient in indicating that the action was being brought "in good faith… to recover the losses incurred by myself and the other class members." Justice Belobaba noted that "very few OSA leave motions fail to clear the good faith requirement." In the absence

6 Parties filing expert evidence on a leave motion are cautioned to ensure that the record contains the necessary evidentiary foundation to support the expert's assumptions, absent which conclusions based on such assumptions may be given little (or no) weight (see *Bradley v. Eastern Platinum Ltd*., 2016 ONSC 1903 at para 99).

7 *Mask v. Silvercorp Inc*., 2015 ONSC 5348 [*Silvercorp*].

8 *Silver v. IMAX Corp., 66 B.L.R. (4th) 222; Dobbie v. Arctic Glacier Income Fund et al*, 2011 ONSC 25.

of clear evidence that the plaintiffs had an ulterior motive or a conflict of interest, it is likely that courts will continue to presume "good faith" where the plaintiff has a personal financial interest and states an intent to hold the defendants accountable on behalf of the class.

Technical Arguments are Less Likely to Succeed

Similarly, courts have been reluctant to dismiss a motion for leave on the basis that a plaintiff's claim fails to meet the technical requirements of a claim as set out in the OSA. For example, in *Swisscanto Fondsleitung AG v. Blackberry*,[9] the Ontario court considered a motion for leave with respect to the failed launch of the Blackberry 10 smart phone. After disappointing sales, Blackberry announced that it was writing off approximately $1 billion of unsold phones and switching accounting methods, which led to a decline in the share price. In defending the leave motion, the defendants argued that the plaintiff had failed to set out a cause of action under the OSA on the basis that Blackberry's statement with respect to its accounting methods did not amount to a "public correction" under the OSA. The court disagreed and held that the purpose of the public correction requirement is not meant to be a significant hurdle at the leave stage – instead, it is meant to serve as a "time-post" for the assessment of damages. The court concluded that Blackberry's statement could "fairly and reasonably be said to be a public correction" of the accounting methods used in the previous two quarters, and granted leave to proceed.

A broad interpretation of the "public correction" requirement was also applied in the *Silvercorp* case. In that case, the defendants argued that the plaintiffs had failed to link a misrepresentation to a "public correction" in their pleading. The court agreed that the pleadings were deficient but, to correct the issue, allowed an unusual post hearing motion by the plaintiff to admit into evidence anonymous internet postings that it claimed were the corrective disclosure. In allowing the motion, the court interestingly found that since "publicly corrected" is not a defined term in the OSA, "an anonymous internet posting that alleges misrepresentation and causes a significant drop in share price" could qualify as corrective disclosure.

Statutory Defences can be relied upon at the Leave Stage

In addition to attacking the merits of the plaintiff's claim, defendants can rely on statutory defences to defeat a leave motion. For example, in *Rahimi v. SouthGobi Resources*,[10] the Ontario court considered a leave motion in a case involving allegations of misrepresentations in the company's financial statement disclosure. In this case, the defendants had issued a press release announcing that previous financial information was no longer accurate and that the company was examining internal controls over financial reporting to identify "material weaknesses."

In defence of the motion, the defendant officers and directors relied on the "reasonable investigation" defence under the OSA, which provides that a person or company is not liable for statutory misrepresentation if (1) it conducted a reasonable investigation before the document was released, and (2) it had no reasonable grounds to believe at the time of the document's release, that the document contained the misrepresentation. Although there has been limited judicial guidance, the first branch of the reasonable investigation defence has been held to involve a consideration of the systems in place at the company concerning financial reporting and disclosure issues, the roles and responsibilities of those involved in such financial reporting and disclosure issues and the oversight and assurance measures, including

9 *Swisscanto Fondsleitung AG v. Blackberry*, 2015 ONSC 6434.

10 *Rahimi v. SouthGobi Resources*, 2015 ONSC 5948.

the performance of audit functions by the external auditor.[11] The second branch has been held to involve a consideration of the specific knowledge of each defendant and the knowledge someone in his or her position ought to have had with respect to any impugned conduct.[12] To date, Canadian courts have explicitly rejected the notion of importing the "business judgment rule" into the reasonable investigation defence on the basis that importing a standard of deference to a director or officer's decision would be both unnecessary and inconsistent with the purpose of the statutory liability regime.[13]

In *SouthGobi Resources*, the court granted leave to proceed against the public company, but not against the officers and directors. In the context of a reasonable investigation defence, a motion for leave will be granted "if there is a reasonable possibility that the defendants will not be able to establish one or both branches of the reasonable investigation defence." Although the court characterized this as a "relatively high hurdle" for the defendants, the defendants met this burden by filing extensive cogent evidence which proved that there was nothing more they could have done to ensure the legitimacy and accuracy of the financial representations at issue.

…courts are willing to play a more rigorous gate-keeper role in dismissing unmeritorious claims at an early stage…

CONCLUSION

The Supreme Court's affirmation of the higher standard to be applied on leave motions, together with recent lower court decisions, indicate that courts are willing to play a more rigorous gatekeeper role in dismissing unmeritorious claims at an early stage with the appropriate evidentiary record. As a result, in appropriate cases, we expect to see extensive efforts by all parties on leave motions, with corresponding voluminous materials and significant upfront costs. Given the increased financial burden at the leave stage, we anticipate a more cautious approach to the commencement of securities class actions by plaintiffs' counsel.

11 *Silver v. Imax*, 66 B.L.R. (4th) 222, at para 361.
12 Ibid., at para 363.
13 *Silver v. Imax Corp.*, 66 B.L.R. (4th) 222, at para 372.

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THE MORE THE MERRIER?

POTENTIAL EXPANSION OF PARTIES TO SECURITIES CLASS ACTIONS AND THE RISE OF GATEKEEPER LIABILITY

Securities class actions generally tend to involve numerous defendants as plaintiffs look beyond the public company defendant to sources for additional monetary recovery, including directors, officers, underwriters, auditors, and other third parties. Several emerging trends, however, suggest that a limitless buffet of potential defendants may not be so readily available to plaintiff investors in Canada.

THE RISE OF GATEKEEPER LIABILITY IN CIVIL ACTIONS

Over the past several years, Canadian courts have continued to consider the scope of auditors' duties. Notable developments include the Ontario Court of Appeal's decision in *Livent Inc v. Deloitte & Touche*[14] upholding the trial judge's $85 million damage award and the $117 million settlement by the auditor of *Sino-Forest Corporation*.[15]

In *Livent*, in particular, the court commented at length on the scope of auditors' liability, noting that the duty of care owed by an auditor of a private company is different than that owed by the auditor of a public company. In the public company context, the auditor must keep in mind the impact of its reports on investors and potential investors.

…a limitless buffet of potential defendants may not be so readily available to plaintiff investors in Canada.

The standard of care required by an auditor of a public company considers whether the auditor has closely adhered "to the dictates of all applicable securities regimes accompanied by a careful attentiveness to the need for accurate financial disclosure to securities regulators and the public." The court emphasized that the circumstances of the particular case would dictate the standard of care and may require the auditor to rise above the minimum standard of a "reasonably competent and cautious accountant", especially in complex or high risk audits. In *Livent*, the auditor's decision to cave under company pressure and recognize a gain in respect of a transaction notwithstanding its initial objections proved fatal. Importantly, the Court's decision limits an auditor's ability to rely on fraud committed by management within the company as a defence to negligence.

A CHECK ON GATEKEEPER LIABILITY IN SECURITIES CLASS ACTIONS

A recent Canadian decision limits the ability to expand statutory liability to third party gatekeepers as "influential persons", specifically "promoters". In *Goldsmith v National Bank of Canada*, the Ontario Court of Appeal denied the plaintiff leave to commence an action against the National Bank of Canada, a financial advisor, in relation to a 2012 public offering by Poseidon Concepts Corp. After the public offering, Poseidon admitted materially overstating its revenues and accounts receivables. The company filed for CCAA protection in April 2013 and was delisted in May 2013, leaving the plaintiff searching for as many other potential defendants as possible.

14 2016 ONCA 11.
15 *Labourers' Pension Fund of Central and Eastern Canada v. Sino-Forest Corporation*, 2013 ONSC 1078.

The company argued that National Bank of Canada was liable as a "promoter" (a type of influential person) for misrepresentations made in the company's circular and prospectus. National Bank was successful in defeating the leave motion on the basis that there was no "reasonable possibility" that it would meet the definition of a "promoter" or "influential person" under the OSA and therefore no reasonable chance it could be held liable for alleged misrepresentations made by a publicly-traded company for which the bank provided financial advice.

A promoter is defined in the OSA as someone who "takes the initiative..." and as such, an entity is a promoter if it plays a driving role in founding the issuer and wield influence comparable to that of an officer or director. Although National Bank had provided loans to a company whose reorganization created Poseidon, this was not sufficient involvement. The Court was clear that the "driving role" is reserved for entities that sit at the heart of the creation of, and decisions made on behalf of, the company. The Court echoed a concern expressed in US jurisprudence that under the plaintiff's broad definition of promoter, lawyers and tax accountants would inappropriately become promoters within the meaning of the OSA.

Ontario Superior Court of Justice has put a further check in place … finding that underwriters are not "experts" for the purposes of the secondary market liability [regime].

A recent decision of the Ontario Superior Court of Justice has put a further check in place limiting potential gatekeeper liability, by finding that underwriters are not "experts" for the purposes of the secondary market liability provisions (Part XXIII.1) of the OSA.[16]

16 *LBP Holdings v. Allied Nevada Gold Corp.*, 2016 ONSC 1629.

THE WATCHFUL EYE OF THE SECURITIES REGULATORS

Canadian securities regulators also play a role in defining and enforcing gatekeeper responsibilities, including as against auditors. The proceedings by the Ontario Securities Commission ("OSC") against Ernst & Young LLP relating to their audits of Sino-Forest Corporation and Zungui Haixi Corporation are examples of the regulator's increased focus on the role of auditors in misleading financial disclosure cases. As noted below, the global accounting firm paid C$8 million to resolve the allegations against it, without any admission of wrongdoing.

In addition to enforcement proceedings, Canadian securities regulators are pursuing regulatory policy initiatives such as National Instrument 52-108: Auditor Oversight, which came in force in September 2014 and OSC Staff Notice 51-720: Issuer Guide for Companies Operating in Emerging Markets, released in March 2012.

OSC Staff Notice 51-720 followed a review conducted by the OSC involving more than half of the 46 emerging market issuers for which Ontario was the principal regulator. The impetus for the review was the fraud allegations levied against Sino-Forest in a short-seller report, which caused the OSC to halt the company's trading and commence proceedings against it. The purpose of the review was to examine the quality and adequacy of issuers' compliance with disclosure requirements and the gatekeeper roles played by auditors and underwriters.

Among other things, the OSC found that the level of engagement by boards and audit committees was deficient. As a result of the review, the OSC strengthened its commitment to work with the Canadian Public Accountability Board (the "CPAB"), the Industry Regulatory Organization of Canada and the audit community, to respond to audit-related concerns and to promote industry best practices for underwriters.

National Instrument 52-108 amended the existing auditor oversight rule to change the triggers for when a public accounting firm must deliver to the regulator a notice relating to remedial actions imposed by the CPAB, with the goal of ensuring that reporting issuers provide more timely and complete information. A consequential amendment to National Instrument 71-102 was also introduced to require certain foreign issuers, including SEC foreign issuers, to comply with the instrument.

These developments are in tandem with similar initiatives of the SEC in 2013 announcing the creation of a Financial Reporting and Audit Task Force to focus on issues prevalent in the industry, such as fraudulent financial reporting and auditors who do not fulfill their gatekeeping role.

3 REGULATORS FIND SUCCESS PROSECUTING INSIDER TRADING CASES

After a string of high profile losses, securities regulators across Canada scored some big wins prosecuting insider trading and tipping cases in 2015. An “at a glance” summary of recent insider trading cases is set out in the chart below. Notable in these decisions was the willingness of the commission panels to rely on circumstantial evidence and inferences in finding the respondents had breached the insider trading and tipping provisions of Securities Legislation and leveling significant penalties.

AZEFF: OSC FINDS LAWYER, INVESTMENT ADVISOR GUILTY OF INSIDER TRADING AND ILLEGAL TIPPING

Perhaps one of the high profile insider trading cases from 2015 is the OSC tribunal decision in *Re Azeff, Bobrow, Finkelstein et al* (“*Azeff*”), in which the OSC found that Mitchell Finkelstein, a prominent Toronto M&A lawyer, had, on six separate occasions, provided material non-public information to his friend Paul Azeff, an investment adviser in Montreal, who had in turn provided that information to four other investments advisers who used the information to purchase shares for themselves, family members and/or clients in violation of sections 76(1) and (2) of Ontario’s *Securities Act*. In each case, Finkelstein was found to be in possession of the information by virtue of his role as the lawyer responsible for the transaction or having access to information in his firm’s computer system. Although the OSC did not have direct evidence establishing that this information was conveyed and traded on, they relied on circumstantial evidence.

Subject to appeals, 2015 may be remembered as the year the hammer came down for respondents in insider trading and tipping cases.

The OSC relied on a wealth of circumstantial evidence regarding, among other things, communications between the respondents, the relationship between the parties, the knowledge that each party had, the subsequent trading activity of the alleged tippees and the timing and volume of the trades in relation to the initiating conversations and successive tips. The OSC expressly stated that circumstantial evidence and inferences are essential to prosecuting such cases, which “are established by a mosaic of circumstantial evidence which, when considered as a whole, leads to the inference that it is more likely than not that the trader, tipper or tippee possessed or communicated material non-public information.” The OSC found that both Finkelstein and Azeff, and some of the alleged “down-stream tippees”, had engaged in unlawful tipping and/or insider trading and imposed significant financial penalties and lengthy or permanent bans on registering or trading securities and acting as a director or officer of a reporting issuer.

AGUECI: CIRCUMSTANTIAL EVIDENCE OVERPOWERS DIRECT TESTIMONY IN OSC FINDING AGAINST FORMER EXECUTIVE ASSISTANT

In *Re Agueci*, another high profile prosecution in 2015, the OSC found an executive assistant in the mining group of an investment dealer, GMP Securities LP, had used her position to obtain and disclose material non-public information about pending merger and acquisition transactions to friends and associates and that she and certain of the alleged “tippees” had used this information to engage in insider trading and tipping contrary to section 76(2) of the *Securities Act* and the public interest.

Like in *Azeff*, the OSC panel relied almost entirely on circumstantial evidence in coming to its decision. Notably in this case, the OSC preferred the strength of Staff's circumstantial evidence to the contrary direct evidence provided by Agueci and certain of the other respondents provided both through *viva voce* testimony and other documentary evidence at the hearing. Similar to *Azeff*, the OSC imposed significant monetary penalties and bans on registering and trading securities and acting as a director or officer of a public company. The penalties imposed on one of the respondents, Dennis Wing, the CEO of another investment dealer, were particularly substantial, totaling over $2.57 million in penalties, costs and disgorgement orders.

PROPOSED *CAPITAL MARKETS ACT*

The continued development in 2015 of the proposed *Capital Markets Act*, which seeks to create a co-operative national system for securities regulation between participating provinces and territories, may expand the jurisdictional reach for future insider trading cases. Under the current draft of the proposed legislation, insider trading prohibitions will be applied extraterritorially, so that persons in a participating jurisdiction who trade in foreign securities listed outside Canada may contravene the Act, even though the foreign entity has no connection to Canada and even though the conduct may be lawful in the foreign jurisdiction. The proposed legislation also permits the regulator to impose administrative monetary penalties of up to $1 million as well as any amounts obtained, or payments or losses avoided, as a result of the contravention.

Importantly, the proposed legislation creates an expanded statutory civil cause of action for insider trading and tipping by all investors who purchased or sold securities during the period between the time the insider trading or tipping occurred and the time the material fact or material change at issue was disclosed to the market.[17] In effect, any investor who trades would have a cause of action, not just investors who traded with the alleged wrongdoer. If enacted, we anticipate that US-style insider trading class action litigation will be initiated in Canada in cases where the potential damages are significant.

Our Securities Litigation team will be monitoring the development of this legislation closely as it may have broad implications for all stakeholders in Canadian public issuers.

KEY TAKE-AWAYS

Subject to appeals, 2015 may be remembered as the year the hammer came down for respondents in insider trading and tipping cases. The apparent increased willingness to rely solely on circumstantial evidence and draw inferences supporting findings of insider trading and tipping demonstrated in cases like *Azeff*, *Agueci* and others, could lead to increased securities regulatory enforcement activity with many more successful prosecutions before Canadian securities commissions.

17 See Section 129 of the consultation drafts of the proposed *Provincial Capital Markets Act.*

At A Glance: Select Insider Trading Cases in 2015

CASE NAME	ALLEGATIONS	RESOLUTION	SANCTION/PENALTY
Re Paul Azeff, Korin Bobrow, Mitchell Finkelstein et al	Tipping, insider trading, acting contrary to public interest	Decision - March 24, 2015. Respondents found guilty of tipping and/or insider trading.	• 10 year ban on registrants or trading in securities • Permanent prohibition/10 year prohibition on becoming an officer or director of a reporting issuer • Administrative penalties: $2,150,000 • Disgorgement of profits: $85,000 • Costs: $375,000
Re Agueci	Tipping, insider trading, making misleading statements, disclosing information regarding OSC investigation	Decision - February 11, 2015. Respondents found guilty of tipping, misleading OSC, breaching information in breach of confidentiality obligations, insider trading.	• Permanent bans on registration, trading and becoming officer or director of reporting issue for certain defendants, 15 year bans for others • Administrative penalties: $2,500,000 • Disgorgement of profits from insider trading: $700,000 • Costs: $675,000
Re Satisk Talawdekar	Tipping, insider trading	Settlement Agreements - March 2015.	• 10 year ban on acting as registrants or trading in securities • Administrative penalties: $77,000 • Disgorgement of profits from insider trading: $12,000 • Costs: $10,000 • Voluntary payment: $35,000
Re Anderson	Insider Trading	Settlement Agreement - May 4, 2015.	• Permanent ban on acting as registrants or trading in securities, becoming an officer or director of a reporting issuer • Administrative penalty: $19,000 • disgorgement of profits from insider trading: $19,000 • Costs: $10,000
Re Holtby (Alberta)	Tipping, Insider Trading	2013 decision; 2015 appeal decision where the issue of sanctions was remitted back to the ASC.	• 10 and 4 year ban on acting as registrants or trading in securities • 10 and 4 year prohibitions on becoming an officer or director of a reporting issuer for Holtby • Administrative penalties: $645,000 • Non-compliance penalties: $135,000 • Costs: $112,500
Re Weicker (B.C.)	Tipping, Insider Trading	Decision - August 28, 2015. Respondents found guilty of tipping/insider trading.	• 2 and 3 year bans from trading in securities of any issuer with whom is in a special relationship • Administrative fines: $100,000 • Payment to the commission: $40,000

4 STICK AND CARROT:

ENHANCED SELF-REPORTING, EARLY SETTLEMENTS AND “BOUNTY” WHISTLEBLOWER REGIMES FOR SECURITIES REGULATORY ACTIONS

The OSC has continued its efforts to expand and utilize mechanisms aimed at early resolution of enforcement matters and at incentives for voluntary reporting of misconduct. The OSC has settled securities regulatory actions through no contest settlements, and has set the stage for early resolution of matters through its pilot Mediation Program. Further progress has also been made on OSC initiatives to encourage self reporting of securities regulatory violations, through the availability of “No Enforcement Action” agreements and the reporting of securities related misconduct through the availability of a whistleblower regime with financial awards. It remains to be seen if other provincial securities commissions will follow suit.

NO CONTEST SETTLEMENTS

“No-contest settlements” were introduced in 2014 through OSC Staff Notice 15-702: Revised Credit for Cooperation Program in an effort to achieve more timely and efficient resolution of enforcement matters. To date, the OSC has approved four no-contest settlements which strongly suggests a firm regulatory commitment to using this new enforcement tool.

First, in *Re Ernst & Young LLP*,[18] the global accounting firm paid C$8 million without any admission of wrongdoing to resolve allegations related to its role and responsibility as external auditor for the financial disclosure of two Canadian companies with Chinese operations, Sino-Forest and Zungui Haixi Corp.

In *Re TD Waterhouse Private Investment Inc. et al*,[19] the TD respondents paid compensation of C$13.5 million to clients and costs and other payments of C$650,000 without any admission of wrongdoing to resolve allegations relating to inadequacies in TD Waterhouse’s internal systems of controls and supervision which resulted in excess fees being charged to clients.

The third no-contest settlement was reached in *Re Quadrus Investment Services Ltd.*,[20] with the respondents agreeing to make a voluntary payment in the amount of C$270,000 to the OSC and to provide compensation to affected eligible clients and former clients in accordance with a compensation plan developed with OSC Staff. The allegations against Quadrus were that certain eligible Quadrus clients were not advised that they qualified for a certain series of mutual funds, and as a result, had indirectly paid excess fees when they invested in a different series of securities of the same mutual fund.

The most significant investor compensation settlement to date was approved in February 2016. In *Re CI Investments Inc.*,[21] the asset-management arm of CI Financial Corp. agreed to pay $156 million to harmed clients who owned mutual funds during a five-year period when the company failed to detect errors in its fund valuation calculations. In addition to restitution for such clients, CI Financial Corp agreed to make a voluntary payment of $8 million to the OSC for investigation costs and to advance the OSC’s mandate of investor protection. This settlement was entered into after CI self-reported the results of an internal review to the OSC in June 2015 and hired Deloitte & Touche to conduct a thorough review of the handling of the valuation calculation. This settlement provides a strong clear example of the benefits of self-reporting and “prompt, detailed and candid co-operation.”

The availability of no-contest settlements depends on a number of criteria, including the timeliness and degree of cooperation, the degree of investor harm, the remedial steps undertaken by the respondent to compensate

18 (2014), 37 OSCB 9227.
19 (2014), 37 OSCB 10742.
20 (2015), 38 OSCB 9531.
21 (2016), 39 OSCB 1739.

investors and prevent future misconduct and the deterrent effect of the settlement agreement on future conduct.

No-contest settlements are *not* available where:

a. the respondent has engaged in abusive, fraudulent or criminal conduct;
b. the respondent's misconduct has resulted in investor harm which has not been addressed in a satisfactory manner; and
c. the respondent has misled or obstructed Staff during its investigation.

According to the former Chair of the OSC, no-contest settlements have become an important component of the OSC's enforcement strategy, and allow for timely and appropriate resolutions in the public interest, while freeing regulatory resources to pursue other activity.[22]

NO ENFORCEMENT ACTION AGREEMENTS

Staff Notice 15-702 also encourages market participant co-operation by providing that Staff may, in limited circumstances, enter into an agreement not to pursue enforcement action in exchange for cooperation.

The availability of no-enforcement action agreements depends on a number of criteria including the extent of the person's self-reporting and remediation, the commitment of the person to provide active and ongoing cooperation in Staff's investigation and prosecution of any other persons in cases involving multi-person misconduct, the degree of investor harm, whether the alleged misconduct reflects an inadvertent, technical or isolated breach, the commitment of the person to pay appropriate amounts in the circumstances, including compensation to third parties and the deterrent effect on future conduct.

The OSC has not publicly disclosed the entering into of any no-enforcement action agreements to date.

OSC PILOT MEDIATION PROGRAM

On May 1, 2015, the OSC's Enforcement Branch commenced its pilot Mediation Program, which was to run through to March 31, 2016. The Program provides parties the option to use a third-party mediator in an attempt to reach a confidential settlement with OSC Staff, and is intended to provide a means to resolve enforcement matters more quickly. A settlement agreement reached through mediation must still be approved by the Commission at a settlement hearing.

As of March 2016, two enforcement matters have been resolved through mediation.[23] At the end of the pilot period, the OSC is expected to provide an update on the effectiveness of the Program and whether it will be continued on an interim or permanent basis.

SELF REPORTING AND WHISTLEBLOWER AWARDS

In October 2015, the OSC released a proposed *Whistleblower Program* (Policy 15-601) with financial rewards to encourage the reporting of securities related misconduct to the OSC. The Commission anticipates that the Policy will "create appropriate incentives for the individual or entity with the most specific, timely and credible information to report to the Commission

22 'OSC Approves Settlement Agreement with Ernst and Young' (30 September 2014); Ontario Securities Commission, www.osc.gov.on.ca/en/NewsEvents_nr_20140930_osc-approves-settlement-agreement-ernst-young.htm.

23 'OSC reports growth in enforcement activity in 2015' (7 March 2016); Ontario Securities Commission, www.osc.gov.on.ca/en/NewsEvents_nr_20160307_osc-reports-growth-in-enforcement-activity.htm.

concerning serious misconduct that may otherwise go undetected... [and] may deter misconduct, and may also encourage self-reporting of misconduct."

Notable features of the Policy include (a) whistleblower protections; (b) restrictions on eligibility based on information received; (c) "tiers" of award amounts based on sanction amounts with a cap of $5 million; (d) no requirement for internal whistleblowers to first fully utilize company compliance and reporting mechanisms; and (e) whistleblowers that were complicit with the misconduct may still receive a monetary reward, though the quantum may be reduced.

Whistleblower Protections

Whistleblowers who are represented by counsel can submit information anonymously to the Commission. However, prior to the payment of an award, the Commission will generally require that whistleblowers reveal their identities for eligibility verification purposes.

Regardless of whether a whistleblower submits information anonymously to the Commission, Staff will "make all reasonable efforts to keep the identity of the whistleblower, confidential (sic) subject to... express exceptions." The OSC has made clear its intention to prosecute any employers for retaliatory actions against whistleblowers under its general public interest jurisdiction.

Whistleblower Eligibility

The eligibility of a whistleblower to receive an award is ultimately at the discretion of the Commission. In order to be eligible for an award "the information should relate to a serious violation of Ontario securities law and be: original information; voluntarily submitted; of high quality; and contain sufficient timely, specific and credible facts relating to the alleged violation of Ontario securities law; and be of meaningful assistance to Staff of the Commission in investigating the matter and obtaining an award eligible outcome." An award eligible outcome will be pursuant to a statutory order "that results in the imposition of total monetary sanctions against, and/or the making of voluntary payments by, one or more respondents in an amount of $1,000,000 or more." Culpable whistleblowers may also be eligible for an award.

Award Amounts

The Commission would pay an eligible whistleblower between 5 and 15% of the total monetary sanctions imposed and/or voluntary payments made. The amount ultimately paid to the whistleblower will depend on the amount of the monetary sanctions imposed and/or voluntary payments agreed to which are *collected* by the Commission. If the total monetary sanctions imposed and/or voluntary payments made in a proceeding, or multiple related proceedings is equal to or greater than $10 million, the maximum amount of any whistleblower award is $1.5 million. If the amount collected by the Commission is equal to or exceeds $10 million, a whistleblower may receive up to a maximum of $5 million.

Comments and Proposed Amendments

The OSC sought comment on the Policy by January 12, 2016. Over 20 comments letters were submitted, many raising concerns that the Policy may create a disincentive to whistleblowers from reporting potential violations through their employer's internal compliance and reporting mechanism. OSC Chair Maureen Jensen recently confirmed that the program should receive final approval in June and launch in early-summer 2016, with a senior OSC staff member heading the OSC's new whistleblower office.[24]

24 McFarland, Janet, "OSC's new whistle-blower office to offer tipsters up to $5 million" (11 April 2016), *The Globe and Mail*, online: www.theglobeandmail.com.

5

SHORT SELLER SCOURGE – MARKET MANIPULATION OR NECESSARY BALANCE?

There is a growing trend in Canada of US-style short sellers releasing negative research publications targeting Canadian and dual-listed issuers. The recent wave started with the publication of the Muddy Waters Research LLC negative research report targeting Sino Forest Corporation ("Sino Forest") in June 2011, which led to a sharp share price decline, followed by a securities class action and regulatory proceedings against Sino Forest, certain directors and officers as well as the company's former external auditor, and the ultimate demise of the company.

In the following years, short seller reports/attacks have spawned a now-familiar pattern of erosion of shareholder value, costly external and internal investigations and, in certain instances, securities class actions. In 2015, short sellers launched a number of attacks on Canadian public companies, but those targets have had limited success mounting a response or seeking the assistance of provincial securities regulators. The chart below provides examples of Canadian public companies targeted by short sellers in 2015.

COMPANY	ALLEGATIONS	CONSEQUENCE
Home Capital Group	US short seller, Marc Cohodes, took a significant short position in Home Capital Group, betting against the Canadian housing market and making public statements that the company was overvalued.	Over 30% decline in July 2015, following news of short selling activity and disclosure that external brokers improperly documented certain mortgages.
Nobilis Health Corp	Allegations by Anson investment Management concerning Irregularities in Nobilis' accounting practices, issues with certain acquisitions and overvalued share price.	Approx. 30% share price decline following publications of the allegations Secondary market liability class action commenced in January 2016.
Valeant Pharmaceuticals International Inc.	Allegations by Citron Research regarding certain accounting irregularities.	Approx. 33% share price decline following issuance of report, much greater decline since Secondary market liability class action commenced in November 2015; company facing regulatory and criminal investigations.
D+H Corporation	Allegations by Lawton Park Capital Management that the company was trying to "obfuscate deteriorating performance with desperate M&A and accounting tricks."	Over 15% share price decline following the issuance of short seller report.
Intertain Group Limited	Allegations by Spruce Point Management regarding various accounting, financial disclosure and management/governance issues.	Approx. 33% share price decline following the issuance of short seller report.

Negative research reports often result in the "bubble bursting" in respect of ostensibly successful companies and correspond to a drop in share price. Apart from the immediate impact of a precipitous share price decline, negative research reports cause reputational damage and often trigger costly internal and external investigations and securities class actions,

the cost for which are typically borne by the remaining shareholders and/or D&O liability insurers.

While short seller reports may serve a useful purpose in some cases, for responsible companies wishing to set the record straight following the release of a short seller report, the path is not always clear. The first step taken by many companies that become the target of a short seller report is to carefully scrutinize the report for any inaccuracies, misleading information or defamatory content in an effort to mitigate market harm and salvage their reputation. Certain companies have had success rebutting short seller allegations by the timely release of responding press releases and results of any independent review of the allegations. Nevertheless, in many instances, regardless of what the target company may say or do, the legal, reputational and financial damage is done and the short seller has profited from the decline (short-term or otherwise) in the company's stock price. Unfortunately, companies have limited options when faced with inaccurate (at best) or deliberately misleading (at worst) short seller reports. To date, civil and regulatory action against short sellers in Canada and the United States has yielded little success, with such actions often being dismissed at the pleading stage.

In its May 2015 decision in *Re Carnes*,[25] the British Columbia Securities Commission ("BCSC") dismissed allegations of wrongdoing and breach of the public interest provisions of the *Securities Act* (British Columbia) against Jon Carnes, a short seller and publisher of a negative research report targeted at Silvercorp Metals Inc., a TSX-listed company with mining assets in China. On September 13, 2011, Carnes (using a pseudonym) published a research report alleging that certain information uncovered regarding Silvercorp's projects "suggests varied reporting, inconsistent reserve numbers, high labour, numerous challenges…" Silvercorp's shares fell 30% that day. The following day, Carnes closed his short position earning a profit of $2.8 million.

BCSC Staff alleged that Carnes committed fraud contrary to the British Columbia *Securities Act* by knowingly misrepresenting and leaving out important facts regarding the conclusions of a geological consultant, for the purpose of causing a drop in the company's share price. Notwithstanding the BCSC's conclusion that "Carnes intended to write the most damaging report he could, to make the most money possible, and was prepared to write things in a way that connoted or implied things that were not explicitly said," it ultimately concluded that there was insufficient evidence to prove fraud.

The BCSC also found that Carnes' conduct was "unsavoury," but not clearly abusive to the capital markets and did not justify of an order in the public interest. In arriving at this conclusion, the BCSC stated that "where the Act prohibits specific conduct, and an allegation involving that type of conduct is found not to contravene the Act, then only in very rare circumstances would it be in the public interest to issue an order based on that same conduct."

It remains to be seen whether, on different facts, target companies or regulators may have better success in combating short sellers; however, the dismissal of the allegations against Carnes is an unwelcome development for target companies and regulators trying to pursue short-sellers for deliberate destruction of share value. Nevertheless, and while short sellers will likely remain a fixture of Canadian capital markets, the BCSC's decision does provide some guidance on how far a short seller can stretch the truth before the regulator will intervene.

25 2015 BCSECCOM 187.

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